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Publication of Gold Survey 2002 - Update 1

Gold price stability expected but investor activity still promises marked volatility

GFMS (Gold Fields Mineral Services) released *Gold Survey 2002 - Update 1* today, their latest report on the gold market. A summary of the findings of *Update 1* was given by Philip Klapwijk, Managing Director of GFMS, at a conference in London organised by the precious metals consultancy.

GFMS forecast that gold prices will average \$316/oz for the second half of this year though they caution a breach of the \$300 or equally the \$330 mark is still possible. Philip Klapwijk commented, "the market is in some ways quite finely balanced. But we could easily see investors upsetting this, especially if Middle East tensions worsen, or a major economic shock occurs. In that case some investors might look seriously at gold as a possible safe haven. On the other hand there's a small, though not negligible, risk that existing investors in gold could become disenchanted with its recent price performance and get out of their positions. And a knock-on effect of this, if the price really does start to slump, is that there could be some defensive hedging."

GFMS mention in *Update 1* that global investment in the first half contributed only 182 tonnes to demand. Klapwijk noted, "this investment was worth a little under \$2 billion - tiny compared to other investment flows during the same period." GFMS believe a key reason that all the recent talk on investment has failed to translate into a stronger market impact is that many investors have sought exposure to the gold price through the purchase of mining company equities rather than bullion itself.

The *Update* picks out producer de-hedging as one of the most influential factors this year. It was estimated to have contributed a record 232 tonnes of demand in the first half, up from 35 tonnes in the first six months of 2001. The reasons cited as the chief factors behind this growth were the low contango, the more positive outlook for the gold price and shareholder pressure. GFMS see de-hedging falling in the second half but not by as much as may be generally expected.

GFMS also believe that the 5% fall in first half mine production was significant. Klapwijk said, "talk of falling output, certainly by as much as 60 or so tonnes, might come as a surprise, and a bullish one at that. But before people get too excited, it's worth remembering that a good part of the fall was due to circumstantial factors - the decline we're expecting for the second half is much smaller and 2003 could even see a rise."

Update 1 goes on to comment that the rise in de-hedging and investment were critical in countering the massive loss in fabrication demand in the first half of 273 tonnes. GFMS cite the sensitivity of demand to a higher gold price in some markets and a stagnant world economy as the chief causes of this drop, two factors they feel will continue to undermine the market in the second half. Klapwijk cautioned, "we do expect fabrication to stabilise in the second half but that's only in comparison to a weak figure in 2001. Prior to that, you have to go back to 1996 to see fabrication as poor."

A corollary to the fall in fabrication, especially in price sensitive markets, was the rising volumes of scrap that GFMS saw being generated. The last major component of supply and demand, official sector sales, is analysed in full in the report but this factor was not seen as having dramatically affected prices given its stability and predictability.

The statistical highlights of the report are outlined overleaf:

Supply Highlights:

- **Mine production** in the first half of 2002 fell a substantial 5% to 1,216 tonnes. Much of the decline was largely due to circumstantial factors in Indonesia though longer term issues were seen to have affected output, especially in the United States. Production for the full year is forecast to fall 3% to 2,514 tonnes.
- First-half cash **production costs** were a modest \$3 lower year-on-year at \$174/oz, partly through currency depreciation. South Africa became the world's lowest cost producer whilst the United States was the highest.
- Net **official sector sales** in January-June were estimated at 290 tonnes, close to 10% higher year-on-year. Sales by the European Central Bank Gold Agreement countries amounted to 231 tonnes. Full year global sales are estimated at 535 tonnes, the same level as in 2001. The first half also saw a moderate decline in central bank lending.
- Higher local gold prices saw **scrap** flows rise by 13% to reach 410 tonnes in the first half. Much of the rise came from the price sensitive markets of the Indian Sub-continent and the Middle East, especially Egypt.

Demand Highlights:

- World **fabrication** fell by a hefty 15% in the first half of 2002 to 1,537 tonnes, an eight year low. Much of the decline was due to the rise in the gold price against a background of a stagnant world economy.
- **Jewellery fabrication** fell by 17% year-on-year to 1,301 tonnes, chiefly due to a slump in the price sensitive Indian market and other developing countries. Many industrialised countries also saw weak consumption due to macro-economic problems. **Other fabrication** (largely industrial gold use) was flat as weakness in Europe and India was broadly balanced by gains in the East Asian electronics sector.
- **World Investment** virtually doubled year-on-year to 182 tonnes in the first of half of 2002. The component that saw the largest change was **implied net investment** which swung from a negative 53 tonnes to a positive 17 tonnes as institutional investors continued to warm to gold. **Bar hoarding** rose a useful 15% to 129 tonnes, chiefly due to a pick-up in Japanese interest, whilst bullion **coin sales** rose just 3 tonnes to 36 tonnes.
- Net outstanding **producer hedge** positions in the first half declined by 232 tonnes as producers unwound their forward sales at an unprecedented rate. Forward sales fell particularly sharply, with an estimated net decline in outstanding positions of around 180 tonnes.

Gold Survey 2002 – Update 1 provides a review of the gold market in the first half of 2002 and a forecast for the full year with 30 pages of statistics, commentary and analysis on all aspects of world gold supply/demand and on gold prices in various currencies. The publication can be ordered from GFMS for £190 or US\$280/Euro290 per copy.

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